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JUN 5 1959
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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1958.

No. [redacted] 94

JOHN C. LEE, Trustee in Bankruptcy of Fox Jewelers, Inc., Bankrupt,
Petitioner,

v.

FOX JEWELRY COMPANY.

PETITION FOR A WRIT OF CERTIORARI.

JOHN C. LEE,
Trustee.

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Petitioner,

v.

FOX JEWELRY COMPANY.

PETITION FOR A WRIT OF CERTIORARI.

Petitioner John C. Lee, acting and qualified Trustee in Bankruptcy of Fox Jewelers, Inc., respectfully prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Fifth Circuit, entered in the above case March 12, 1959.

OPINIONS BELOW.

The order of the Referee in Bankruptcy containing the issues, findings of fact and conclusions of law, was entered in writing (R. 325-333). The order of the United States District Court for the Northern District of Georgia sustaining the order of the Referee on the petition for review filed by the appellee was entered with opinion (R. 343). The opinion of the United States Circuit Court of Appeals for the Fifth Circuit (App. 49), is reported in .... F. 2d ...

JURISDICTION.

The judgment of the Circuit Court of Appeals for the Fifth Circuit was entered on March 12, 1959 (App. 52). The jurisdiction of this Honorable Court is invoked under 28 U. S. C. A. 1254 (1), and 11 U. S. C. A. 47 (c).

QUESTIONS PRESENTED.

I.

Whether or not the Honorable Circuit Court of Appeals for the Fifth Circuit erred in its reversal of the order of the District Court for the Northern District of Georgia, which approved the findings of fact and conclusions of law of the Referee in Bankruptcy:

(a) That the Referee had summary jurisdiction to require respondent to surrender its assets to the Trustee.

(b) That the respondent was not a bona fide adverse claimant, but its claim was merely colorable and not real.

(c) That the possession of the property by respondent was fraudulent.

(d) That the transfer of the property by the bankrupt to the respondent, a corporation wholly owned and controlled by the same stockholders and directors as that of the bankrupt, had the effect of hindering, delaying or defrauding the bankrupt's creditors.

(e) That the merchandise transferred from the bankrupt to the respondent was made in violation of the Bulk Sales Law of Georgia and therefore void.

II.

Whether or not the said Circuit Court of Appeals erred in holding that the Referee's findings of fact, sustained by the said District Court, were clearly erroneous. (11 U. S. C. A. 53, General Order No. 47 in Bankruptcy.)

REASON FOR REVIEW ON WRIT OF CERTIORARI.

The decision of the Circuit Court of Appeals for the Fifth Circuit in the case at bar is in conflict with the decisions:

(a) Of this Honorable Court, as follows:

Sampsell v. Imperial Paper & Color Corp., 313 U. S. 212, 85 L. Ed. 1292.

(b) Of the Court of Appeals for the following circuits:

Fish v. East, 114 F. 2d 177 (C. C. A. 10);
Clark Supply Company, 172 F. 2d 248 (C. C. A. 7).

(c) Of the Appellate Courts of Georgia, as follows:

Sampson v. Brandon Grocery Co., 127 Ga. 454;
Wyon Shoe Co. v. Daniels & Co., 136 Ga. 192.

(Said decisions are based on Georgia Code Section 28-201, et seq.)

and the decisions of other Circuit Courts of Appeal hereinafter cited.

The decision in the case at bar, if not reversed, will have the following effect:

(A) It eliminates for all intents and purposes the summary jurisdiction of the bankruptcy court in the Fifth Circuit:

(1) Though a bankrupt's property is in the possession of parties whose claims are not real or substantial, but merely colorable, but is constructively in the possession of the bankrupt;

(2) Though a party not adverse is in possession of property by fraudulent means;

(3) Where a violation of the Georgia law applicable to sales in bulk exists.

(B) It eliminates in fraudulent conveyance cases the equitable summary power of the bankruptcy court and it will hinder and delay the orderly proceedings in bankruptcy as contemplated under Section 11; U. S. C. A. 46.

STATEMENT OF THE CASE.

Because of the similarity of the names of some of the parties involved, they are herein referred to as follows:

Fox Jewelers, Inc., the bankrupt, as "Atlanta Corporation."

Fox Jewelry Company, the respondent in the turnover proceedings before the Referee in Bankruptcy, and respondent herein, as "Marietta Corporation."

John C. Lee, the duly acting and qualified Trustee of the Atlanta Corporation, and petitioner herein, as "Trustee."

Robert Feldser, who at all times was the sole stockholder and president of the Atlanta Corporation and the Marietta Corporation, as "Feldser."

Feldser was engaged in the retail jewelry business in Atlanta, Georgia, as an individual, prior to March, 1955, under the name of Fox Loan Association. In March, 1955, Feldser organized the Atlanta Corporation and about the same time the Marietta Corporation (R. 17, 149), and he was in complete charge of the business operations of both corporations (R. 45, 46). Feldser then transferred a portion of the assets and liabilities of Fox Loan Association to the Marietta Corporation and a portion to the Atlanta Corporation, and issued to himself the entire capital stock of both corporations in return for the net worth (R. 149). At all times Feldser was the sole stockholder, the president and general manager of both of said corporations, and

his wife was the only other officer (R. 18). For a short period of time from the inception of said corporations, they had three directors as required by Georgia law, but thereafter they had only two directors. The Atlanta Corporation carried on its business in Atlanta Georgia, and the Marietta Corporation in Marietta, Georgia (some twenty miles from the Atlanta store).

The Atlanta Corporation filed a voluntary petition in bankruptcy in the United States District Court for the Northern District of Georgia, Atlanta Division, listing liabilities of approximately $52,000.00 and assets of approximately $23,500.00, and was adjudicated a bankrupt by the Honorable Frank Hooper, District Judge, on March 3, 1958. On the same date the bankruptcy matter was referred by the said Judge to the Honorable J. Ellis Mundy, Referee in Bankruptcy (R. 4). John C. Lee was appointed Receiver and thereafter elected Trustee. On April 4, 1958, two separate petitions for turnover orders were filed by the Trustee. One was filed against Feldser as an individual for the turnover of two automobiles, and the other against the Marietta Corporation, Feldser, and his wife, for the turnover of the assets of the Marietta Corporation (R. 4). By agreement of the parties evidence adduced at the various creditors' hearings was used by the Referee in connection with the turnover procedings (R. 324).

(Evidence).

The evidence adduced before the Referee at the hearings on March 17, 1958, March 27, 1958, and April 29, 1958 (the dates being significant because the petition for turnover was filed April 4, 1958 and the response on April 29, 1958), revealed the following factual situation:

Though both the Marietta Corporation and the Atlanta Corporation were organized as separate entities, their affairs were interwoven, their properties commingled. Feld-

ser and his wife operated said corporations as a single unit and entity. The Atlanta Corporation bought all merchandise in its name and transferred the same to the Marietta Corporation, and from time to time the Marietta Corporation transferred merchandise to the Atlanta Corporation (R. 52). The merchandise which was so transferred to the Marietta Corporation was not billed to the Marietta Corporation (R. 129, 131, 192), nor did it pay for the merchandise, neither did the Marietta Corporation bill merchandise to the Atlanta Corporation or the Atlanta Corporation pay for it to the Marietta Corporation (R. 128). If and when the Marietta Corporation had funds, Feldser would transfer cash from the Marietta Corporation to the Atlanta Corporation (R. 94, 164, 168). The Atlanta Corporation and the Marietta Corporation kept insufficient records of the transactions between themselves and it could not be determined with any degree of accuracy what amount of merchandise and inventory was transferred from the Atlanta Corporation to the Marietta Corporation, or from the Marietta Corporation to the Atlanta Corporation (R. 165), nor what amounts are due the Atlanta Corporation by the Marietta Corporation.

All merchandise for both the Atlanta Corporation and the Marietta Corporation was purchased by Feldser in the name and on behalf of the Atlanta Corporation (R. 201) and billed by the creditors to the Atlanta Corporation (R. 132). At Feldser's sole discretion and direction part of such merchandise was transferred from the Atlanta Corporation to the Marietta Corporation in bulk and out of the ordinary course of business, and at times from the Marietta Corporation back to the Atlanta Corporation. No daily records were kept of such transfers (R. 204). At the end of the month Feldser would tell his bookkeeper the net amount of the merchandise transferred. The bookkeeper swore that tickets were made showing the net amount of such transfers, but Feldser could only produce

and introduce into evidence one single ticket which was many months old. No invoices were made showing in detail the source, amount, kind, or cost of the merchandise (R. 41, 51, 52, 127-131, 164, 165, 192-202). The bookkeeper, Mary Wallace, was presented the books of both corporations and was requested to point out from the records kept by her (R. 192) the monthly entries which she claimed were made by her showing such transfers (R. 196), but the said Mary Wallace was unable to do so since no entries had in fact been made.

Entries made on the purchase journal (R. 201, etc.) were merely the amount of merchandise bought by the Atlanta Corporation and intended to be allocated to the Marietta Corporation (R. 165), but such allocations were mere bookkeeping entries. No entries of any transfer or allocation were made for January or February, 1958 (R. 194-199). The books and records further indicated that of the total purchases of the Atlanta Corporation for the year 1958, only approximately $16,000.00 worth of merchandise was allocated to the Marietta Corporation. However, the Marietta Corporation did more retail business than the Atlanta Corporation, and the total purchases made by the Atlanta Corporation were approximately $50,000.00 (R. 231, 232, 233). Witnesses for the Marietta Corporation were unable to explain this discrepancy. The accountant, who was the same accountant for both the Atlanta Corporation and the Marietta Corporation, swore that he had no way of allocating the payables between the Atlanta Corporation and the Marietta Corporation (R. 252). Feldser could not, from the books and records, break down the purchases (R. 48, 49), and only cash receipts and accounts receivable records were kept separately between the two corporations (R. 77).

Expenses of the separate corporations were not separated and charged to each corporation, but were arbitrar-

ily allocated by the auditor (R. 139, 140, 155, 165, 166, 204-5, 243-4).

The funds realized by the Marietta Corporation from the sale of merchandise and the collection of accounts were deposited in a bank account in Marietta, Georgia and were then withdrawn two or three times per week from said account (R. 169), and deposited in a bank account of the Atlanta Corporation and commingled with the funds of the Atlanta Corporation (R. 94, 127, 128, 155, 156). The withdrawals were in round figures (R. 224-5) and had no relation whatsoever to the merchandise furnished or services performed by the Marietta Corporation. The Marietta Corporation's bank account was merely used and intended as a clearing account (R. 168). The monies so withdrawn and commingled with the Atlanta Corporation's funds were used to pay the expenses of both corporations (R. 226, 230, 228, 229) and to pay bills for merchandise without specifically applying the Marietta Corporation's funds to the merchandise which was transferred from the Atlanta Corporation to the Marietta Corporation (R. 229). The witnesses were unable to make any distinction as to whether money was expended on behalf of the Atlanta Corporation or the Marietta Corporation (R. 227, 231, 252-6).

With the exception of an organizational meeting and a directors meeting to authorize the making of a loan at the Citizens and Southern National Bank, no stockholders or directors meetings were held since the organization of both corporations (R. 18, 26), except to authorize the filing of a voluntary petition in bankruptcy on behalf of the Atlanta Corporation.

All records of both corporations were kept in one book by the Atlanta Corporation (R. 48, 60) by the same bookkeeper at the Atlanta office and the accounts were combined (R. 95). The books and records were not audited.

but the auditor prepared statements from the books for tax purposes (R. 75). Eighteen months previous to bankruptcy, the bankrupt realized difficulty in paying its bills (R. 23, 24). It was advised by the auditor to liquidate or sell its business because of the continuous losses. The Atlanta Corporation was insolvent many months before bankruptcy (R. 23, 24, 307), and its business was hopeless as far back as 1956 (R. 172). The bankrupt owed merchandise creditors for practically twelve months and for all the merchandise it bought during 1957 (the bankruptcy occurred in March, 1958 (R. 171). The auditor had not been paid for more than a year (R. 245). Discontinuance of the business was recommended by the auditor more than twelve months previous to bankruptcy (R. 244).

Taxes withheld from the salaries and wages of the employees of both corporations were commingled and deposited in a bank account in the name of the Atlanta Corporation (R. 94).

One hospitalization policy was carried by the Atlanta Corporation for the employees of both corporations (R. 93).

While Feldser swore that an inventory was actually taken at the end of the fiscal year listing the items and the cost thereof in detail and turned over to the auditors, nevertheless, the records of such inventories had been destroyed (R. 134) and were not available. Feldser and the bookkeeper swore that the inventory sheets had been turned over to the auditor, but the auditor swore that he was given only the totals (R. 31, 32, 33, 74, 134, 190). The auditor testified that in his opinion the inventory figures given him were based on a percentage rather than on an actual physical inventory (R. 166).

In addition to the foregoing, the testimony is full of conflict, one of the most glaring conflicts being as follows:

Feldser swore that he had not given or shown a financial statement of the affairs of either corporation during the year 1957 or 1958, and although he was repeatedly questioned on this point (R. 32, 33, 58, 59, 145, 146, 166), he denied the giving of such statement with the exception of a statement for the period ending February 28, 1957. An officer of the Citizens and Southern National Bank of Atlanta, Georgia, testified that Feldser gave him a statement of both corporations in February, 1958 (shortly before bankruptcy) for the period ending December 31, 1957, and that Feldser requested the return of the statements. Photostatic copies of the statements were made by the Bank and retained by it and the originals were returned to Feldser (R. 288-9).

(Findings and Conclusions of Referee, R. 325-333.)

As a result of the testimony, the Referee in Bankruptcy found in favor of the Trustee on both turnover proceedings. The Referee found that requisite corporate formalities were not followed, that loose bookkeeping practices were followed with entries unsupported by detailed records, that all purchases were charged to the bankrupt, transfers were made to the Marietta Corporation without preservation of detailed records of such transfers, and merchandise was at all time subservient to the beck and call of Feldser, the president and alter ego of the bankrupt. Thus it remained in possession of the bankrupt. Since there were not sufficiently detailed records of the transactions between the two corporations, the Referee found that the claim of the Marietta Corporation was merely colorable and that, therefore, he had summary jurisdiction in this proceeding. In his conclusions of law the Referee stated:

> "If the two corporations were distinct entities, as respondents contend, would not the numerous transfers

of merchandise in bulk between the two corporations be amenable to the Bulk Sales Law and the limitations imposed thereunder?"

"The acts of one ambidextrous man may not be substituted for arm's length transactions merely because of his ambidexterity" (R. 332).

The findings of fact and conclusions of law of the Referee were affirmed by the District Court (R. 343-346) upon a petition for review filed by the respondents in the turnover proceedings. Both respondents then appealed to the Circuit Court of Appeals for the Fifth Circuit, which Court sustained the order in the case against Feldser concerning the automobiles, but reversed the decision of the District Court involving the assets held by the Marietta Corporation. This petition for writ of certiorari, therefore, involves only the judgment of the Circuit Court of Appeals respecting the assets held by the Marietta Corporation.

ARGUMENT.

Petitioner respectfully contends that the Referee in Bankruptcy was correct in sustaining the turnover petition filed by the Trustee against the Marietta Corporation in holding that he had summary jurisdiction, in findings in favor of the Trustee upon evidence adduced, and in summarily adjudicating the issues, and that the District Court of the United States for the Northern District of Georgia properly affirmed the findings of fact and conclusions of law of the Referee, and that the Circuit Court of Appeals for the Fifth Circuit was in error in reversing the lower courts.

I.

Source of Bankruptcy Court's Jurisdiction.

The summary jurisdiction of the United States District Court in bankruptcy stems from the decisions of the courts based on Bankruptcy Act 11, U. S. C. A., paragraph 45:

> "The United States District Court shall have jurisdiction over all controversies at law and in equity, **as distinguished from proceedings under this Act** between receivers and trustees, as such, and adverse claimants, concerning the property acquired or claimed by the receiver or trustee, in the same manner and to the same extent as though such proceedings had not been instituted and such controversies had been between the bankrupt and such adverse claimant."

This Code Section makes a jurisdictional distinction in bankruptcy cases between controversies and proceedings under the Act. Controversies are reserved to the jurisdiction of the District Courts and may be decided only in plenary actions, **while proceedings in bankruptcy** over which the bankruptcy court, or by assignment to him the

Referee in Bankruptcy has jurisdiction, are to be disposed of in a summary manner. **Collier on Bankruptcy, Vol. 2, Section 23.02, page 437.**

That summary jurisdiction in the Referee, as the same applies to turnover proceedings, is essential and necessary to accomplish the efficient and expeditious function of the Referee in the administration of bankruptcy estates, has been recognized by the Courts and has been affirmed by this Court repeatedly. **Maggio v. Seitz, 333 U. S. 56-94, 92 L. Ed. 476.**

Summary proceedings are of less formal nature than plenary actions, but pleadings are nevertheless required. The respondent or claimant is entitled to reasonable notice and has a right to be heard. **Collier on Bankruptcy, Vol. 2, para. 23.10, pages 533-4.**

In the case at bar the respondents were not only heard to the fullest extent, but they filed responsive pleadings to the petition of the Trustee, introduced lengthy evidence, and filed briefs.

Ordinarily, the turnover order may not result from the general examination of the bankrupt **(In re Monroe, 48 Fed. Supp. 932)**. However, in the case at bar it was stipulated between the Trustee and the respondent that all the evidence produced at the general examination of the bankrupt may be considered by the Referee in deciding the issue under the turnover petition (R. 324).

II.

Court Must Look Into Its Own Jurisdiction.

After a petition for a turnover order has been brought it then becomes the duty of the court to determine if it has summary jurisdiction. A refusal or failure to inquire into the jurisdiction and to dismiss the turnover petition with-

out such determination is error. This principle of law has been recognized by this Court and followed by the Circuit Court of Appeals for the Fifth Circuit in 1945 in the case of **Atlanta Flooring and Insulation Co., Inc. v. Russell, 146 F. 2d 884,** a case which originated in the United States District Court for the Northern District of Georgia, and resulted in a reversal of the District Judge because he declined to determine whether the Court had summary jurisdiction in requiring the State Court Receiver to turn over property allegedly belonging to the bankrupt and in the possession of the State Court Receiver. Judge Holmes said:

> "The court below at least had summary jurisdiction to inquire into its own jurisdiction and this it failed to do sufficiently."

This principle of law has also been approved by this Court.

> "It (the court) has both the power and the duty to examine a claim adverse to the bankrupt estate to the extent of ascertaining whether the claim is ingenious and substantial."
>
> **Cline v. Kaplan, 332 U. S. 97, 89 L. Ed. 97-99,** citing **Harrison v. Chamberlin, 271 U. S. 191, 70 L. Ed. 897.**

The effect is that the mere assertion of an adverse claim does not oust a court of bankruptcy of its summary jurisdiction. The respondent having timely and in writing objected to the summary jurisdiction of the Referee, and the Referee after an examination of the facts set out by the Trustee in his turnover petition, and after hearing evidence having ruled adversely on the contention of the appellants, the Referee, therefore, complied with the mandate of the law and determined he had summary jurisdiction. His determination affirmed by the District Court, if such determination is to have meaning, should not be

lightly reversed by the Appellate Court as the hearing before and findings of fact of the bankruptcy court would otherwise become a futile gesture.

III.

Summary Jurisdiction of the Bankruptcy Court.

Section 23 of the Bankruptcy Act (11 U. S. C. A., para. 46) does not restrict the power of the Bankruptcy Court to act summarily; it is only denied summary jurisdiction if the claim is substantially adverse (**Atlanta Flooring and Insulation Company, Inc. v. Russell**, supra). More specifically, summary jurisdiction lies when the bankrupt is in "constructive possession" of property and constructive possession occurs where the property:

(a) is in the physical possession of the bankrupt at the time of the filing of the petition but is not delivered by him to the receiver or trustee; or

(b) is in the hands of the bankrupt's bailee or agent; or

(c) is held by some other person who makes no claim to it; or

(d) **is held by one who makes the claim which is not substantial or is colorable only.**

Collier, Vol. 2, para. 23.05, pages 473-476.

Notwithstanding Section 23, if a preliminary inquiry discloses that claim of title to or interest in property held adversely to bankrupt is without substance but merely colorable or fictitious, the Bankruptcy Court may proceed to adjudicate it summarily.

"A claim is to be deemed substantial, if there are probable facts or circumstances sufficient to support a reasonable legal hypothesis upon which it should be allowed; it is held to be colorable if the contention

in support of it is so plainly without merit as to amount to a mere pretense. If found to be merely colorable the court may then proceed to adjudicate the merits summarily, but if found to be substantial, it must decline to determine the merits and dismiss the summary proceeding." **Atlanta Flooring and Insulation Company, Inc. v. Russell,** supra.

"If a preliminary inquiry discloses that claim of title to, or interest in, property held adversely to bankrupt is so completely without substance as to be merely colorable or fictitious, bankruptcy court may proceed to adjudicate it summarily, but if claim is found to be real or substantial the jurisdiction of the Court to proceed summarily ends and the trustee is relegated to a plenary action unless claimant assents that controversy be adjudicated in bankruptcy court." **Davidson v. Scofield, 153 F. 2d 7 (C. C. A. 10).**

"Where adverse claims to property are only colorable claims and not real or substantial ones, summary turnover proceeding before the Referee is proper." **Arnold v. King, 236 F. 2d 877 (C. C. A. 9).**

If property is in constructive possession of the bankrupt the court has the authority to proceed to a determination of the adverse claim in a summary manner. **Taubel-Scott-Kitzmiller v. Fox, 264 U. S. 427-30, 68 L. Ed. 770; Thompson v. Magnolia, 309 U. S. 478, 84 L. Ed. 876.**

To aid the court in its preliminary jurisdictional inquiry, the court is given a wide latitude and it may examine into all the evidence.

"The bankruptcy courts for purpose of determining whether alleged adverse claims are substantial or merely colorable may examine into all the evidence and admission submitted and as a part of its finding on which conclusion that jurisdiction exists express itself in a qualified sense on the merits of the con-

troversy. Irving Trust Company v. Fleming, 73 F. 2d 423; In re: Eilers Music House, 270 F. 915, and authorities cited on page 924; In re: Franklin Suit and Shirt Co., 197 F. 591, 600; Cohen v. Hessel, 278 F. 929; In re: Holbrook Shoe and Leather Co., 165 F. 973."

Fish v. East, 114 F. 2d 177-189.

We do not believe that it will serve any useful purpose in citing the many cases which deal with the extent of the latitude of the court's authority, but will confine ourselves to cases wherein summary jurisdiction was taken, and which deal either with multiple corporations which are controlled by the same stockholders, directors or officers, or to cases where the claimant was a subsidiary corporation or controlled by the bankrupt.

A subsidiary corporation case with which the decision in the case at bar is in conflict is the case **In re Muncie Pulp Company, 139 F. 546 (C. C. A. 2)**. Certiorari denied. 202 U. S. 621, 50 L. Ed. 1175. The issues in that case were as follows:

The bankrupt was a New York corporation engaged in manufacturing at Muncie, Indiana, Blackman being its president and Jaeger its treasurer, and the stock was owned by these two men, Blackman owning the majority. The bankrupt purchased and leased gas and oil wells and land for gas and oil well drilling for its Muncie plant; and because of financial difficulty the Buck Creek Natural Gas Company was organized under Indiana law "to furnish Muncie with gas and oil". For technical reasons a new company, known as Great Western Natural Gas and Oil Company, was organized to take the place of the Buck Creek corporation, and Blackman became the president and majority stockholder of Great Western, and Jaeger the treasurer and minority stockholder. The bankrupt transferred the gas and oil property to Buck Creek and Buck Creek to Great Western. Great Western kept no

separate set of books; its entire administrative department was under the control of the bankrupt. The receiver brought a summary turnover petition against Great Western for the property, which was granted.

Just as in the case at bar, the stock of the two corporations was owned by the identical stockholders, and appellants maintained that the order entered upon the decision was beyond the jurisdiction of the District Court and that they held the property which they were directed to turn over in their own proper right, owning, holding, and claiming to own and hold the same adversely to the receiver, and that the order is unlawful and violates the constitutional rights of the claimants, in that it takes away their property summarily without trial and without due process of law.

The Appellate Court ruled:

> "The principal question presented is one of fact; that being determined, there is little difficulty about the law."
>
> "In legal effect it was as if the Pulp Company had, for convenience in transacting business, transferred its oil lands, in trust, to an independent agent, and upon his becoming incapacitated, to a second agent for like purposes. Can there be any serious doubt that the court would pre-emptorily reject a claim that these agents, or either of them, had acquired a title adverse to the principal? . . . **if the petitioners succeed in their contention the result will be that, upon liquidation, there being no creditors of the Great Western Company, the valuable property transferred to it will be divided among its shareholders, namely Blackman and Jaeger—the president and treasurer of the Pulp Company, and the men, who of all others, should be most solicitous to protect the Company and its creditors from such spoliation.**"

"The facts being so plain, an extended discussion of the law seems unnecessary."

"Surely the bankrupt law is not so vitally defective that the court cannot direct the president of a bankrupt corporation to turn over property of the bankrupt in his hands or under his control."

While the decision rests upon the findings that the individuals held the stock of Great Western as Trustee, nevertheless it is noteworthy that the result in the case at bar would be the same as in the Muncie case, in that upon liquidation of the Marietta Corporation, Feldser would stand to benefit from the receipt of merchandise for which the creditors have not been paid, and that of all persons he should be solicitous to protect the bankrupt and its creditors.

This case was cited with approval by this Court in **Sampsell v. Imperial Paper and Color Corporation, 313 U. S. 212, 85 L. Ed. 1292.**

The Seventh Circuit decided the case of **In re Clark Supply Company, 172 F. 2d 248**, and a companion decision is reported in 172 F. 2d 254, wherein it appeared that prior to bankruptcy E. H. and B. E. Clark did business as a partnership under the name of Clark Supply Company, and operated several related enterprises. After withdrawing large sums of cash which had the effect of leaving the partnership without working capital, they devised a plan as follows:

(1) Terminate the partnership.

(2) Terminate the partners' personal liability to creditors.

(3) Form a number of corporations to be owned and controlled by the Clarks.

(4) Transfer to the corporations the assets of the partnership.

(5) Have each corporation operate a different enterprise formerly operated by the partnership.

(6) Cause the corporations operating potentially losing enterprises to assume and agree to pay the partnership debts.

(7) Transfer valuable property of the partnership to corporations operating potentially profitable businesses.

After the aforesaid plan was put into effect, the corporation, loaded with bad business and debts, became bankrupt. Its Trustee brought turnover proceedings to reach the assets of Todd, one of the corporations to whom assets were given. The Referee found that all the corporations were under the absolute dominion and control of the Clarks, who continued to operate and use them as one business. All the corporations had identical officers, directors and stockholders. **Though separate books and records were maintained they were all kept at the office of the bankrupt by one staff of bookkeepers and an accountant employed by the bankrupt under the sole direction of the Clarks. Assets were transferred from one corporation to another at the will and to suit the purposes of the Clarks in total disregard of the Clarks' fiduciary duties** as custodians of the assets of each; there was indiscriminate commingling of the assets of the four corporations; the business affairs, property and assets of these corporations were treated by Clarks as one business, **under one management; proceeds and funds raised by assignment of accounts of one company were utilized in the interest of the others; and the bankrupt was made to do the buying for all of the corporate respondents,** except certain machines which were purchased directly (See page 251).

In the case at bar, the Marietta Corporation raised funds by assignment of book accounts and the proceeds derived from such assignment were transferred to the

bankrupt (R. 147, 163-4), and he "pulled money out of Marietta just to keep things going" (R. 23-4).

The Court of Appeals in affirming the decision and basing it on the **Sampsell v. Imperial Paper and Color Corporation** case, supra, held that though the decision is supported by an abundance of substantial evidence and that appellant's claim is colorable only and for that reason the court had summary jurisdiction to proceed.

The case at bar is also in conflict with **Fish v. East, 114 F. 2d 177 (C. C. A. 10).** This was a turnover proceeding brought by the Trustee in Bankruptcy of Royal Tiger Mines Company, hereinafter referred to as "Mines Company." The officers, directors and attorneys for Mines Company formed Tiger Placer Company, hereinafter referred to as "Placer," of which they were also the officers, directors and attorneys. Certain assets of Mines Company were turned over to Placer in exchange for Placer's stock. Placer's stock was held by certain of the officers, directors and attorneys as Trustees for Mines Company, so that neither the stock nor the assets of Placer could be reached by the creditors of Mines Company. This transfer was held to be in fraud of creditors and void under Colorado law. The financial structure of Placer left Mines Company in complete control. Mines Company and Placer were operated as one company. The stock of Placer was sold to the public, but the money received was used indiscriminately for both companies. The property of both companies was commingled. Funds were shifted as needed from one company to another. There was no separation made of which lands each company was to mine. Personal property of both companies was stored in the same warehouse and not segregated or in any manner marked or distinguished. Real estate of both companies was returned as a single unit for tax purposes. Separate books of account were kept, but no real distinction was made between the transactions of both

companies. In addition to the foregoing, Mines Company guaranteed certain debts of Placer.

The court found that the transfer of assets was made "to hinder and delay" creditors, using the following language on page 182:

> "Not only is a conveyance illegal if made with an intent to defraud the creditors of the grantor, **but also equally illegal if made with an intent to hinder and delay them.** Many an embarrassed debtor holds the genuine belief that if suits can be staved off for a season, he will weather a financial storm, and pay his debts in full. Shapiro v. Wilgus, 287 U. S. 348, 53 S. Ct. 142, 77 L. Ed. 355, 85 A. L. R. 128, 131; Means v. Dowd, 128 U. S. 273, 281, 9 S. Ct. 65, 32 L. Ed. 429. The belief, even though reasonably well founded, does not clothe such debtor with a privilege to build up obstructions that will hold his creditors at bay."

On page 188 the court discussed at length the summary jurisdiction of the bankruptcy court and upheld the findings of fact that the transfers were made to hinder and delay creditors, and that the property was commingled and that separating it for the purpose of administration or delivery could not be done; that money was transferred from one corporation to the other as directed by one of the officers, and even though **separate** books for the two companies were kept by the same bookkeepers, audited by the same auditors, using the same office and office equipment, etc. (page 191), the Appellate Court sustained the findings of the Referee.

One of the earlier cases in which summary jurisdiction was sustained is **In re Eilers Music House, 270 F. 915 (C. C. A. 9).**

Eilers Music House, hereinafter referred to as "Music House", was a corporation which became a bankrupt in

the year 1918. A proceeding in the nature of a turnover proceeding was instituted by the Trustee of Music House against Oregon. The facts were as follows:

In 1908, a corporation hereinafter referred to as "Piano House", purchased the stock of Graves & Co., another corporation. Music House, the bankrupt herein, was organized in 1910, and Piano House conveyed certain of its property to Music House, which assumed and agreed to pay all of the debts of Piano House. Certain property obtained from Graves by Piano House was conveyed to Oregon in 1910. For several years Oregon did business as the agent and representative of bankrupt Music House and held all of the property for Music House. In 1916, Music House sold a store which it operated to Oregon, taking Oregon's stock in payment. Music House then caused Oregon to change its name, to move part of its business to premises leased by Music House, taking a sublease. On the basis of these facts, the Court found that bankrupt executed control over Oregon, and Oregon's property was ordered dealt with as the property of the bankrupt. The facts are lengthy, but it seems from the dissenting opinion that **the bankrupt only had a minority stock interest in the corporation** against which the summary proceeding was instituted, and yet the Appellate Court upheld the order sustaining the appellant.

There the respondent **denied that it was a constituent or subsidiary part** of the business of the bankrupt corporation.

One of the leading cases is the case of **Sampsell v. Imperial Paper and Color Corporation, 313 U. S. 212, 85 L. Ed. 1292.** The facts in this case are more completely set out in 114 F. 2d 49 (C. C. A. 9). The Court of Appeals reversed the District Judge who had sustained the Referee in exercising summary jurisdiction, but this Court reversed the Court of Appeals. It appeared that Downey, the

bankrupt, was heavily indebted to Standard with which he had a distributorship arrangement. Downey operated a general mercantile business. The arrangement with Standard provided that all net profits from the mercantile business would be applied toward payment of the indebtedness to Standard. As part of his mercantile business, Downey dealt in paint and wallpaper which he could not obtain from Standard. Downey applied for credit to Imperial. Imperial would not extend credit to Downey because of the arrangement with Standard. In order to obtain credit from Imperial, Downey, his wife and son, formed a corporation which was completely subject to Downey's control. Downey sold his paint and wallpaper inventory to this corporation. The corporation then bought from Imperial and carried on a paint and wallpaper business. The corporation and Downey occupied the same premises. **Their goods, however, were not intermingled and their business was kept separate and distinct.** Standard knew of the sale to the corporation. The Bulk Sales Law of California was complied with in all respects. Despite the above separation of assets and records, the Bankruptcy Court in summary proceedings treated the property of the corporation as the property of the bankrupt. **Apparently the only factual ground for this action was Downey's control of the corporation, though the bankrupt only retained twenty-seven shares of fifty shares issued by said corporation, and, at the time of the hearing he only owned five shares.**

The Court of Appeals decided that the evidence did not show:

> "That the sale by the bankrupt to the corporation was made with the intent to delay or defraud creditors. But even if it did that it would not justify the Referee's order, for the sale did not involve any property dealt with or affected by the Referee's order . . . **that stock** (inventory) was disposed of **by the**

corporation long prior to the filing of the petition in bankruptcy."

It held:

"That if the corporation was the bankrupt's alter ego that would not justify the order on review. For not only did that order treat the corporation as the bankrupt's alter ego; it disregarded the existence of the corporation as a separate legal entity. To warrant such disregard of the corporation's separate existence it was necessary to show, not only that it was the bankrupt's alter ego, but that to recognize its separate existence would promote fraud, defeat justice, or produce inequitable results."

The Supreme Court in reversing the Court of Appeals held:

"The order entered in the summary proceedings against Downey, his wife, his son and his family corporation was a final order binding as between the parties. **There can be no question but that the jurisdiction of the bankruptcy court was properly exercised by summary proceedings.** The circumstances are many and varied where an affiliated corporation does not have, as against the trustee of the dominant stockholder, the status of a substantial adverse claimant within the rule of Taubel-Scott-Kitzmiller Co. v. Fox, 264 U. S. 426, 68 L. Ed. 770, 44 S. Ct. 396, 2 Am. Bankr. Rep. (N. S.) 912. The legal existence of the affiliated corporation does not per se give it standing to insist on a plenary suit. Re Muncie Pulp Co. (C. C. A. 2d), 139 F. 546, 14 Am. Bankr. Rep. 70; W. A. Liller Bldg. Co. v. Reynolds (C. C. A. 4th), 247 F. 90, 40 Am. Bankr. Rep. 371; Re Rieger (D. C.), 157 F. 609, 19 Am. Bankr. Rep. 622; Re Eilers Music House (C. C. A. 9th), 270 F. 915, 46 Am. Bankr. Rep. 526; Central Republic Bank & T. Co. v. Caldwell (C. C. A.

8th), 58 F. (2d) 721, 21 Am. Bankr. Rep. (N. S.) 168; Commerce Trust Co. v. Woodbury (C. C. A. 8th), 77 F. (2d) 748; Fish v. East (C. C. A. 10th), 114 F. (2d) 177, 44 Am. Bankr. Rep. (N. S.) 206. Mere legal paraphernalia will not suffice to transform into a substantial adverse claimant a corporation whose affairs are too closely assimilated to the affairs of the dominant stockholder that in substance it is little more than his corporate pocket. Whatever the full reach of that rule may be, it is clear that a family corporation's adverse claim is merely colorable where, as in this case, the corporation is formed in order to continue the bankrupt's business, where the bankrupt remains in control, and where the effect of the transfer is to hinder, delay or defraud his creditors. Re Schoenberg (C. C. A. 2d), 70 F. (2d) 321, 25 Am. Bankr. Rep. (N. S.) 262; Re Berkowitz (D. C.), 173 F. 1013, 22 Am. Bankr. Rep. 233. And see Glenn, Liquidation, §§ 30-32, Cf. Shapiro v. Wilgus, 287 U. S. 348, 77 L. Ed. 355, 53 S. Ct. 142, 85 A. L. R. 128. Hence, Downey's corporation was in no position to assert against Downey's trustee that it was so separate and insulated from Downey's other business affairs as to stand in an independent and adverse position."

It seems to use that the action of the Court of Appeals for the Ninth Circuit is very similar to the action of the Circuit Court of Appeals for the Fifth Circuit, in the case at bar, and that the only difference is that the bankrupt in the **Sampsell** case was an individual, whereas in the case at bar the bankrupt is a corporation, but the facts in the case at bar are stronger because **the only inventory which was in the hands of the respondent was inventory acquired from the bankrupt itself**, contrary to the facts in the Sampsell case.

Claims Arising Out of Violation of Bulk Sales Law of Fraudulent Transfers Are Not Substantial or Adverse Claims.

We contended before the Referee, in the United States District Court, as well as before the Circuit Court of Appeals, that even if the Atlanta Corporation and the Marietta Corporation were in truth and in fact separate and distinct entities and had there been no intermingling of the affairs and joint control by the same officers and directors, and had the transfers from the Atlanta Corporation to the Marietta Corporation been otherwise proper, then nevertheless such sales would be in violation of the Bulk Sales Law of the State of Georgia, Sections 28-203-6 (App. 47), which make it a fraudulent and void transaction to transfer in bulk any stock of goods, wares or merchandise **out of the usual and ordinary course of business or trade of the vendor.** The evidence showed that the Atlanta Corporation, as well as the Marietta Corporation, was strictly organized to conduct a retail business. Its usual and ordinary course of business, therefore, was retail sales and a transfer of substantial portions of its inventory or large sales in bulk was therefor in violation of the Georgia Bulk Sales Law.

Sections 28-203-6 of the Code of Georgia prescribe the method of making sales in bulk out of the ordinary course or trade of the seller. Under Section 28-203 it is the duty of the purchaser who purchases any stock of goods, wares or merchandise in bulk for cash or credit, before paying any part of the purchase price to demand and receive from the seller or managing officer or agent of the corporation a written statement under oath of the names and addresses of all creditors and the amount owed them, and it is the duty of the seller to furnish it. The seller must also furnish to the purchaser a statement of his assets and liabilities and the cost price of the merchandise to be sold,

the cost to be arrived at by an inventory taken at the time by the seller and the purchaser.

Then under Section 28-204, the purchaser must, at least five days before the completion of the purchase or the payment therefor, notify personally or by registered mail each of the creditors of the proposed sale, the price to be paid, the terms and conditions thereof, and to furnish a statement of assets and liabilities. Any failure to comply with Section 28-203 or 4 makes the sale or transfer, as to any and all creditors of the seller, to be **conclusively presumed to be fraudulent** under the express language contained in Section 28-208.

Section 28-206 defines what type sales are fraudulent and it specifically states that any sale or transfer of a stock of goods, wares or merchandise **out of the usual and ordinary course of business or trade** of the vendor, or whenever thereby substantially the entire business or trade theretofore conducted by the vendor shall be sold or conveyed or attempted to be sold or conveyed to one or more persons.

It must be noted that either a sale out of the ordinary course of business **or** the sale of substantially all of the assets requires the compliance with the Bulk Sales Law of Georgia in order to take it out of the Fraudulent Conveyance Act.

The Code Sections above quoted have been interpreted and applied repeatedly by the Appellate Courts of Georgia, and the Courts have required and demanded a strict compliance. Any sale or transfer of goods, wares or merchandise in bulk in violation thereof is fraudulent. It will suffice to cite a few of the Georgia cases:

W. B. Parham & Co. v. Potts-Thompson Liquor Co., 127 Ga. 303.

"Construing the Act of 1903 (28-203 ours) and 2697 (now Section 28-301) together, we may easily reach

the conclusion that sales of stock in bulk by a debtor to a creditor, in extinguishment of his debt, in whole or in part, are still permissible, but such sales are **null and void** unless there be compliance with the terms of the Act of 1903." **Sampson v. Brandon Grocery Co., 127 Ga. 454.**

Wyon Shoe Co. v. Daniels & Co., 136 Ga. 192.

In the following case a sale of the assets was made by a corporation to its president and by him sold to a third party who knew that the provisions of the Bulk Sales Law of Georgia had not been complied with, and the Georgia Supreme Court ruled as follows:

"Where a mercantile corporation turns over its stock of merchandise to its president and principal stockholder, who undertakes to buy up at a discount the claims against the corporation and who, after purchasing a majority of such claims, sells the stock of merchandise in bulk to a third person who knows that the corporation's president is buying up the claims against the corporation, and that some of the claims had not been purchased at the time of the sale, such a transaction falls within the operation of the sales-in-bulk statute; and the sale by the president of the corporation to such third person without complying with the terms of the statute **is void** as against creditors of the corporation." **Kight v. Stephen Putney Shoe Co., 137 Ga. 493.**

See also:

Anderson v. Merchants and Miners State Bank, 161 Ga. 12;

Virginia-Carolina Chemical Co. v. Bouchelle, 12 Ga. App. 661;

Moultrie Grocery Co. v. Holmes-Hartsfield Co., 22 Ga. App. 512;

Haralson v. Mendel, 36 Ga. App. 174;
Goodman v. Clarkson, 39 Ga. App. 383;
Gross v. Grossman, 2 F. 2d 458 (C. C. A. 5).

Even in the absence of the Georgia Bulk Sales Law the transaction of the nature involved would be in violation of the Statute 13th Elizabeth, which is still in force in Georgia under the common law: **Westmoreland v. Powell, 59 Ga. 256.** The provisions of the Code of Georgia relative to fraudulent conveyances are amendatory only and the Statute 13th Elizabeth has not been repealed.

The nature of the transactions between the Atlanta Corporation and the Marietta Corporation is also in violation of the Fraudulent Conveyance Act of Georgia, Section 28-201, which is amendatory to the Statute of 13th Elizabeth and which declares that conveyances made for the purpose and with the intent to delay or defraud creditors and others of their just and lawful actions, suits, debts, accounts, damages, etc., are void (see **McDowell v. McMurrie, 107 Ga. 812-816**), and the Bulk Sales Law apparently is a regulatory provision which may be used as a safeguard against violation of Section 28-201 and the Statute of 13th Elizabeth.

The Statute was invoked in 1927, after the enactment of the Bulk Sales Law in 1903 in the case of **Varn Investment Co. v. Bankers Trust Co., 165 Ga. 694,** wherein the Supreme Court upheld the following charge of the court to the jury:

> "There may be circumstances attending the conveyance and transfer of property intended to hinder, delay or defraud creditors, which are denominated 'badges of fraud.' These badges of fraud do not, in themselves or per se, constitute fraud, but are rather signs or indicia from which its existence may be properly inferred as a matter of evidence."

"The transfer or conveyance of all or nearly all, of his property by a debtor, especially **when he is financially embarrassed,** is a badge of fraud, **not being in the usual course of business.**"

"Circumstances indicating excessive effort to give the transfers or conveyances the appearance of fairness or regularity, which are not usually found in such transactions, are to be regarded as badges of fraud."

"In the case of a conveyance of property, when the buyer employs the seller to carry on the business or property conveyed, **so that the seller uses and controls the property as he did before the sale,** it is a circumstance which the jury may consider in passing upon the validity or invalidity of the transaction, and creates a strong presumption of fraud."

"The failure to examine property, **or take an inventory of goods bought, or looseness or incorrectness in determining the value of the property conveyed, may be badges of fraud.**"

In Georgia, just like in many other States, possession of personal property by a vendor after an absolute conveyance is a badge of fraud. **Goodwin v. Goodwin, 20 Ga. 600.** If possession is a badge of fraud, then it seems to us that the absolute control over personal property would likewise be a badge of fraud.

Bankruptcy courts under the jurisdiction of the various Circuit Courts of Appeal, other than the Fifth Circuit, have ruled that summary jurisdiction exists where the property is in the possession of a claimant who acquired it in violation of the Bulk Sales Law and at least one of those cases has been cited with approval by this Court. The Ninth Circuit in the case of **Arnold v. King, Trustee, 236 F. 2d 877,** held:

"Even in America, the Horatio Alger catapulting of trucker to tycoon is open to suspicion—especially when

Horatio Alger heads an organization apparently used as a dummy to conceal a bankrupt's assets.

"And when we find a violation of the Bulk Sales Act, RCW, 63.08.010 et seq., an attempt to assert a colorable adverse claim in order to divest the referee of summary jurisdiction, suspicion becomes almost a certainty."

In that case it appeared that the bankrupt, a partnership consisting of James C. Bookey, Sr., and his son, James G. Bookey, Jr., the trustee filed a turnover petition against Arnold and Eggs, Inc., to whom the bankrupt had transferred property in violation of the Bulk Sales Law. The Referee's summary order directing the appellants to turn over certain described property was reviewed and sustained by the District Court and affirmed by the Court of Appeals over the objection of the appellants' assertion that it "truly appears" from the petitions by the trustee that they are plenary suits against third parties to recover property adversely held by them and without their consent. The Court held:

"The appellants' adverse claims are not real or substantial but merely colorable."

"(1) When that is the case a summary proceeding before the referee is proper." (Citing **Harrison v. Chamberlin, 271 U. S. 191, 70 L. Ed. 897**).

The court cites with approval the following excerpt from the referee's memorandum decision:

"(2) Failure of the bankrupt to comply with the Bulk Sales Act made this transaction fraudulent and void and the uncorroborated story as told (by Plumer and Junior) was so improbable and fraudulent on its face that the action of this court in taking summary jurisdiction is amply supported by the following authorities." (Citing cases.)

In the case of **In re Schoenberg, 70 F. 2d 321,** decided by the Second Circuit, the individual Schoenberg was adjudicated a bankrupt and nine months before bankruptcy he caused a corporation to be organized to which it sold merchandise in violation of the Bulk Sales Law of New York. The trustee in bankruptcy filed a petition with the referee charging that the transfer was void under the Bulk Sales Law and praying that the corporation be ordered to turn the assets over to him. Apparently the referee decided that the claim was merely colorable, for his certificate on review cites that his order was based upon the fact that the corporation "was a cloak for the bankrupt" and that the assets had been voluntarily transferred to it without notice to creditors as required by the Bulk Sales Law . . . but where the transferee is a corporation organized by the bankrupt to continue his business, with the capital stock representing only the assets transferred, with the bankrupt in control of the business, and with an admitted failure to comply with the Bulk Sales Act, we think finding is justified that the corporation is a mere cloak for the bankrupt and its adverse claim merely colorable. Jurisdiction of the referee is therefore sustained.

The **Schoenberg** case was cited by this Honorable Court in **Sampsell v. Imperial Paper and Color Corporation, 313 U. S. 212, 85 L. Ed. 1292.**

We are aware of the facts that there are authorities to the effect that under certain circumstances summary jurisdiction does not lie against an adverse claimant who has acquired assets in violation of the Bulk Sales Law. These cases are not applicable to the facts in this case, where the transferee corporation, as well as the bankrupt corporation, is wholly owned by the same stockholders and where such transactions under Georgia law are absolutely void.

To make a transaction fraudulent it does not require the presence of all three elements, to-wit: The hindering,

delaying and defrauding, as throughout the Georgia law and decisions the disjunctive preposition "or" appears, so that the mere act which "delays" a creditor is sufficient.

> "In overruling the objections of the Trustee, the Referee found that, in order to justify objector's claim, it must appear that the corporate entity of the bankrupt was being fraudulently and wrongfully used in order to perpetrate a fraud and that this fact must be affirmatively proved as in the case of any fraud. This is not the rule applied in the Sixth Circuit as is clear from an examination of the following cases . . .". **Otsego Waxed Paper Company, 14 F. Supp. 15.**
>
> **In re Clark Supply Company,** supra.

In **Buckwalter v. Wipple, 115 Ga. 484,** the auditor found that the transfer was made for the purpose of "hindering, delaying and defeating" and it was held that the evidence was sufficient to support that finding, though fraud was charged.

The Georgia Bulk Sales Law sections must be strictly complied with and are to be construed liberally for the benefit of the defrauded creditors. **Duncan v. Freeman, 152 Ga. 332.**

We strongly argued orally and in writing in the Courts below that the Marietta Corporation's claim is not adverse because it acquired its inventory from the Atlanta Corporation in violation of the Georgia Bulk Sales Law. The Referee considered the issue and in his conclusions of law (R. 332) made the following statement:

> "If the two corporations were distinct entities, as respondents contend, would not the numerous transfers of merchandise in bulk between the two corporations be amenable to the Bulk Sales Law and the limitations imposed thereunder?"

Briefs were filed on the petition for review before the District Court and again this point was insisted upon. The District Court took note and found (R. 345):

> ". . . the transfer of the merchandise was made in violation of the Bulk Sales Law of the State of Georgia. **Arnold v. King, 236 F. 2d 877; Schoenberg, 70 F. 2d 321.**"

Again in the Court of Appeals for the Fifth Circuit petitioner in his oral argument and in his brief, relied on his right of recovery on the violation of the Georgia Bulk Sales Law, but the Court of Appeals entirely ignored the issue and in the decision it made no reference to this point or the Georgia law.

Therefore, if the decision is allowed to remain, then in the Fifth Circuit the violation of the Bulk Sales Law of the various States does not give summary jurisdiction to the bankrupt court, though this court in **Sampsell v. Imperial Paper and Color Corporation**, supra, upheld the **Schoenberg** case and applied 13th Elizabeth.

Bankruptcy Courts Have Equity Power.

Courts of bankruptcy are courts of equity (11 U. S. C. A. 11), and in order to do justice to the creditors are permitted to look through corporate veils.

As stated by the Court of Appeals for the Fifth Circuit, we argued that this was a case in which there was no difficulty in piercing through the corporate veil. If, as the court indicates by implication, that there may be ample basis for a finding in a plenary proceeding that the bankrupt has been imposed upon by the respondent and the respondent is accountable to the bankrupt for such imposition, then the court must have had in mind that the Marietta Corporation was the alter ego of the Atlanta Corporation and that the transactions were fraudulent

and void and the conclusion should have followed, under the cases cited, that summary jurisdiction lies. Fraudulent debtors may not hide themselves behind cloaks which are used for the purpose of hindering, delaying or defrauding creditors. The equity power of the court, in addition to some of the cases cited hereinabove, was discussed and upheld in the following cases.

In **Hunter v. Baker Motor Vehicle Company, 225 F. 1006,** the corporate entity was disregarded where the corporation was so organized and controlled and its affairs were so conducted as to make it merely an instrumentality or adjunct of another corporation. It was also held in other cases:

> "In at least three recent decisions this court has stressed the principal that a court of bankruptcy is a court of equity. If this pronouncement is to amount to more than a mere succession of words making grammatical sense it seems that the parties in a bankruptcy proceeding should act with uberrima fides.
>
> "In other words, the participants in a bankruptcy suit are to be judged, to borrow the classic prose of Mr. Justice Cardozo, according to standards that are 'stricter than the morals of the market place'." **Acme Distributing Co. v. Collins, 247 F. 2d 607 (C. C. A. 9).**
>
> "But there is an exception to the entity rule, where its recognition would result in promoting illegality, fraud or injustice . . . where it is so employed the law will disregard the rule, go behind the fiction and treat the stockholders as if the corporation did not exist." **Eichelberger v. Arlington Bldg., Inc., 280 F. 997-999.**
>
> "Upon the facts as found by the two courts below we must take it that the corporation was a mere tool of Smith, that his knowledge was its knowledge . . . this being so, the difference in legal personality between Smith and the corporation gives the corporation

no greater rights than Smith. It cannot be privy to a fraud, and on the ground of its success set up title of which, if that be material, Smith is to have substantially the whole advantage." **Linn and Lane Timber Co. v. United States, 236 U. S. 574, 59 L. Ed. 725.**

"The bankruptcy court, being a court of equity, looks beyond the mere outward shell to the parties in interest—beyond the fiction of law and corporate forms, to the purposes and officers who are identified with that purpose." **In re Wolfe Industries, 56 F. 2d 64-67 (C. C. A. 5).**

The corporate veils were pierced in the **Clark Supply Company** case, supra, in **Fish**, supra, and in the following case:

"Under equitable powers inherent in bankruptcy courts, subordination of claims is an established remedy where equitable principles require its application."

"Dealings of officers, directors or stockholders with corporation are subject to vigorous scrutiny and where claims against bankrupt corporation are challenged, stockholder has burden of proving, not only good faith in the transaction, but its inherent fairness from viewpoint of the corporation and those interested therein." **In re Loewer's Grambrinus Brewery Co., 74 F. Supp. 909.**

See also:

Taylor v. Standard Gas & Electric Company, 306 U. S. 307, 83 L. Ed. 669;
Pepper v. Litton, 308 U. S. 295, 84 L. Ed. 281;
Henderson v. Rounds and Porter Lumber Company, 99 F. Supp. 376.

"Looking to the actualities in the matter, the court is convinced that the defendant controlled and manipu-

lated the Flooring Company to such an extent that it should be charged with the obligations giving rise to the plaintiff's claim." **Henderson v. Rounds and Porter Lumber Company, 99 F. Supp. 376-384, D. C. Ark.**

"It is familiar that a court of equity will not allow a corporate fiction to destroy the rights of creditors, where an element of fraud either in fact or in law exists, and that form or guise will be disregarded and the substance considered . . . if one corporation is wholly under the control of another, the fact that it is a separate entity does not relieve the latter from liability for its acts, and even when one corporation is the owner and proprietor of another, the latter will be disregarded as a mere trade name, and the real beneficiary cannot resort to the fiction of claiming in the name of the latter to defeat bona fide creditors." **In re Marcella Cotton Mills, 8 F. 2d 522.**

It obviously makes no difference whether the individual stockholders directly deal with the bankrupt corporation or whether they use a circuitous route by organizing or having organized a second corporation to deal with the bankrupt corporation.

None of the inventory which was in possession of the Marietta Corporation at the time of the Atlanta Corporation's bankruptcy had been purchased from third parties, but all of it came from the Atlanta Corporation. Purchases made during the year by the Atlanta Corporation were approximately $50,000.00 and the bankrupt's total liabilities were $50,000.00 or more, so that none of the purchases of merchandise which were made during the year, and which were in part allocated to the Marietta Corporation, had been paid for by the Atlanta Corporation. Had the Marietta Corporation purchased its merchandise direct from the various manufacturers or wholesalers instead of transferring funds from the Marietta Corporation

to the Atlanta Corporation, which were used interchangeably by the Atlanta Corporation to pay its debts and some of the expenses of the Marietta Corporation and for merchandise without regard to the separation of purchases, then the creditors of the merchandise which went to the Marietta Corporation would have been paid for. In equity and in good conscience the Marietta Corporation cannot contend, being controlled by the same interests and not being a stranger to the transaction, that it had no knowledge that the Atlanta Corporation had not paid for the merchandise in the possession of the Marietta Corporation. As a result of the scheme the Marietta Corporation has now on hand a substantial stock of merchandise which it knows has not been paid for and the creditors of the merchandise have no direct recourse by independent suit against the Marietta Corporation. Surely courts of equity will not lend their aid to schemes as these and will compel the Trustee to bring a plenary suit and be faced with a delay incident to the litigation, and in the meantime have a fraudulent debtor in possession of property and allow it to dissipate the assets. No trustee would take a chance of asking a District Court for a receiver and be faced with the necessity of a bond to protect the debtor against loss from the operation of an already losing business, and no surety company, in our humble opinion, would write such bond. In the instant case, though not appearing in the record, respondent gave a forthcoming bond and remained in possession of its assets.

Finding of Referee Should Be Accepted Unless Clearly Erroneous.

Contrary to the overwhelming authorities, the Court of Appeals ignored the findings of fact of the Referee and affirmed by the District Court, which were entitled to great weight and should have been accepted by the Court of Appeals unless clearly erroneous.

General Order No. 47 in Bankruptcy, 11 U. S. C. A. 53, provides:

> "Unless otherwise directed in the order of reference, the report of a Referee . . . shall set forth his findings of fact and conclusions of law, and the Judge shall accept his findings of fact unless clearly erroneous. The Judge after hearing may adopt the report or may modify it or may reject it in whole or in part or may receive further evidence or may recommit it with instructions."

Except in extreme cases have the Courts reversed the findings of fact when concurred in by the District Judge. Some of the Courts have ruled that the findings of fact have the effect of a jury finding and have said that they are bound by the findings.

> "Bankruptcy court is required to accept findings of fact made by Referee unless clearly erroneous." **Frazer v. Ash, 234 F. 2d 320 (C. C. A. 5).** Certiorari denied, 352 U. S. 893.

See also:

Wingart v. President Directors & Company of Hagerstown Bank, 41 F. 2d 660. Certiorari denied, 283 U. S. 382.

Lines v. Falstaff Brewing Company, 233 F. 2d 927. Certiorari denied, 352 U. S. 893.

Earhart v. Callan, 221 F. 2d 160. Certiorari denied, 350 U. S. 829.

> "We believe counsel to be in error because the scope of the review by a District Court of findings of fact made by a referee is established by Order No. 47 of the General Orders in Bankruptcy, 11 U. S. C. A. following section 53, and the scope of our review of a District Court in cases like the present is established by Rule 52 (a) of the Federal Rules of Civil Proce-

dure, 28 U. S. C. A. following section 723c. Order No. 47, supra, provides that the District Court 'shall accept his (a referee's) findings of fact unless clearly erroneous' and Rule 52 (a), supra, provides that we shall not set aside a District Court's finding of fact 'unless clearly erroneous.' The applicability of Order No. 47 of the District Court in this case is obvious. The applicability to us of Rule 52 (a) is by force of Rules 1 and 81 (a) of the Federal Rules of Civil Procedure, and Orders No. 36 and 37 of the General Orders in Bankruptcy. See Katcher v. Wood, 8 Cir., 109 F. 2d 751; Coursey v. International Harvester Co., 10 Cir., 109 F. 2d 774; Scott v. Jones, 10 Cir., 115 F. 2d 133.

"Therefore, whatever the rule may formerly have been, the scope of our review of findings of fact made by a referee and adopted by a District Court is now narrowly limited. The question for us in this case is whether the District Judge committed clear error in accepting the referee's findings of fact for the reason that he was unable to say that those findings were clearly erroneous." **Brown v. Freedman, 125 F. 2d 151 (C. C. A. 1).**

"And it being well settled that concurrent findings of the Referee in Bankruptcy and the District Judge will not be set aside on appeal on anything less than demonstration of **plain** mistake." **Jack v. Shuster, 234 F. 2d 694 (C. C. A. 6).**

In re Willoughby, 95 F. 2d 932 (C. C. A. 6). Certiorari denied. 305 U. S. 604, 83 L. Ed. 384.

"Such findings are **presumptively** correct and will not be set aside unless clearly erroneous." **Gold v. Gerson, 225 F. 2d 859 (C. C. A. 9).**

"His findings were, therefore, binding on the Judge below—and equally binding on [illegible]." **In re Di Palo, 218 F. 2d 816 (C. C. A. 2).**

"In law cases the findings of fact of the lower court are equivalent to the verdict of a jury and will be disturbed on appeal only when shown to be clearly erroneous. In equity an appeal brings both the facts and the law before the reviewing court, and here both the law and facts have been reviewed by this court. Findings of fact of an equity court are not reviewable unless, on examination of all evidence, they appear to be clearly wrong." **Hudson v. Wylie, 242 F. 2d 435 (C. C. A. 9).**

Nowhere was it set out by the respondent in its appeal wherein the conclusions of fact as found by the lower courts were incorrect; neither does the Court of Appeals in its decision deal in detail with the evidence, but it dismisses the findings of fact lightly with the statement:

"Without discussing the facts in detail other than as above set out, we think there is no basis whatever in the record for the exercise of summary jurisdiction."

It is our position that there was ample evidence to justify and to prompt the lower court's holding that it had summary jurisdiction, and that such findings of fact were not clearly erroneous as was decided by the Court of Appeals in its reversal.

CONCLUSION.

Whenever the acts of a bankrupt, its officers, affiliated corporations or subsidiaries, result in an injustice and the claimant corporation is the alter ego of the bankrupt or is a mere cloak, the bankruptcy courts are given summary jurisdiction to pierce the corporate veil. Some of the cases which involve the dealings of officers or stockholders with bankrupt corporations are the following additional ones:

Reifsnyder v. B. Levy & Son, 88 F. 2d 287;
Rabinovitz v. Oughten, 92 F. 2d 297;

Danish v. Sofranski, 93 F. 2d 424;
Bank of California National Ass'n v. McBride, 132 F. 2d 769.

Judge Learned Hand has stamped his disapproval on contracts between corporations where the contractual power is in one person, such as it was in Feldser.

> "A contract between two companies all of whose shares are held by a single shareholder, in a fundamental sense, cannot create an obligation, for an obligation implies a power in one person to control, to coerce, the will of another, and there is only one will concerned." **In re Hicks & Son, 82 F. 2d 277 (C. C/A. 2).**

The Circuit Court of Appeals in the case at bar relied only on one of its previous decisions, to-wit: Maule Industries v. Gerstel, 232 F. 2d 297. While we agree with the decision in the Maule case, yet we feel that the case is not authority for the case at bar because in the Maule case all the assets were in the hands of a State Court Receiver, who has been held by the courts to be an adverse party, and because the two corporations were not organized by the same parties, nor was their business identical; in that case the Referee ordered a consolidation of the two corporations within five days after a show-cause order had issued, and he entered such order in effect by default; no proof had been presented that the assets had been commingled or that the corporations had the same creditors; and yet, in the Maule case the Circuit Court of Appeals (though not in the case at bar) cited with approval **Fish v. East**, supra.

The only other case the court saw fit to refer to was the case of **Sampsell v. Imperial Paper & Color Corporation,** supra, but we respectfuly contend that the **Sampsell** case is authority for our position and not for the decision of the Court of Appeals in the case at bar.

Our position that summary jurisdiction lies in the case at bar is amply supported by the cases cited, and that the Referee and the District Judge were correct in holding that the claims of the respondent are merely colorable and not substantial, that they cannot be deemed to be adverse claimants because of their relationship to the bankrupt.

The Referee heard the witnesses in person, had the opportunity to and did observe their conduct, sincerity or insincerity, considered rightfully their relationship and interest and noticed the evasiveness of many of their answers. Many of the records which we asked for were destroyed or allowed to be destroyed (if they ever existed), such as the inventory records and documents showing the disposition of merchandise between the interrelated companies, such acts being committed during periods when both companies were fast approaching insolvency or were insolvent, and at a time when the principal stockholder and president was advised to sell the business because the situation was hopeless.

There was, of course, nothing illegal in keeping consolidated books and accounts, but the fact that the parties saw fit to average the gross profits of the two corporations and arbitrarily allocate expenses, exchanged merchandise without making records or keeping records, and without the preservation of the cost records, is indicative of the fact that Feldser did not operate the businesses as separate and distinct corporations.

The Referee very specifically found that:

> "Transfers were made to the Marietta Corporation without preservation of proper detailed records of such transactions. Such merchandise was subservient, we think, to the beck and call of Feldser, the president and 'ego' of bankrupt. Thus it remained in possession of bankrupt. There were no

sufficiently detailed records of the transactions between the two corporations, we think, upon which Fox Jewelry Company could predicate a claim to the property" (R. 330),

and he reached his legal conclusion finally and rightfully on **Loewer's Grambrinus Brewery Company, 74 F. 2d 909,** that a corporate entity is not sacred and will not be recognized when to do so would work fraud or injustice. The Court ruled in said case:

> ". . . These equitable powers, inherent in bankruptcy courts, have been invoked to the end that fraud will not prevail, that substance will not give way to form, and that technical considerations will not prevent substantial justice from being done. They have been applied in passing upon claims presented by officers, directors or stockholders, whose dealings with the corporation are subjected to rigorous scrutiny; and where such claims are challenged, the burden is on the stockholder not only to prove good faith in the transaction but also to show inherent fairness from the viewpoint of the corporation and those interested therein. The essence of the test is whether or not under all of the circumstances the transaction carries the ear marks of an arm's length bargain. If it does not, equity will set it aside. That standard of fiduciary obligation is designed for the protection of creditors as well as stockholders."

To avoid an attack such as was made in this case by the Trustee, it was incumbent upon the claimant in the interest of fair play with the creditors to have records sufficiently detailed to reveal honest and above board dealings between the two corporations and not limit itself to the production of one single ticket, which only showed the monthly difference between the merchandise transferred to the Marietta Corporation and the mer-

chandise received by the Atlanta Corporation from the Marietta Corporation.

The respondent should suffer the penalty of the loose transactions and bookkeeping practices and the Trustee was entitled to invoke the equity power of the bankruptcy court in summarily seeking the turnover of the assets. But more important, it should have been the duty of an honest man to buy the merchandise needed by the Marietta Corporation in the name of the true beneficiary and recipient and not in the name of an insolvent corporation, when he knew that the Atlanta Corporation would never pay for it and at a time when it was faced with bankruptcy. Surely the court will not stamp its approval on such a devise initiated by a person who is the sole stockholder of both corporations and in full control and management thereof. We respectfully contend that the Referee was justified and correct in his findings of fact and conclusions of law, and petition this Court to grant this petition for writ of certiorari so that the errors of the Court of Appeals for the Fifth Circuit may be corrected.

Respectfully submitted,

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JOHN C. LEE, Trustee.

Of Counsel:

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for
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APPENDIX.

Chapter 28-2. Acts Void As Against Creditors.

"28.201. (3224) **Enumeration of void acts.**—The following acts by debtors shall be fraudulent in law against creditors and others, and as to them null and void, viz: (Act 1818, Cobb, 168. 59 Ga. 258)."

"1. Every assignment or transfer by a debtor, insolvent at the time, of real or personal property, or choses in action of any description, to any person, either in trust or for the benefit of, or in behalf of, creditors, where any trust or benefit is reserved to the assignor or any person for him. (Act 1818, Cobb, 168. Acts 1865-6, p. 29.)"

"2. Every conveyance of real or personal estate, by writing or otherwise, and every bond, suit, judgment and execution, or contract of any description, had or made with intention to delay or defraud creditors, and such intention known to the party taking. A bona fide transaction on a valuable consideration, and without notice or ground for reasonable suspicion, shall be valid."

"3. Every voluntary deed or conveyance, not for a valuable consideration, made by a debtor insolvent at the time of such conveyance."

"28-203. (3226) **Merchandise, how sold in bulk.**—It shall be the duty of every person who shall bargain for or purchase any stock of goods, wares, or merchandise in bulk, for cash or credit, before paying or delivering to the vendor any part of the purchase price therefor, to demand and receive from the vendor thereof, and if the vendor is a corporation, then from the managing officer or agent thereof, a written statement under oath of the names and addresses of all the creditors of said vendor, together with the amount of indebtedness due or owing by said vendor

to each of such creditors; and it shall be the duty of such vendor to furnish such statement. It shall further be the duty of said vendor to give to the vendee a statement of his assets and liabilities and the cost price of the merchandise to be sold, said cost price to be arrived at by an inventory taken at the time by the seller and purchaser. (Acts 1903, p. 92.)"

"28-204. (3227) **Duty of purchaser.**—Thereupon it shall be the duty of the purchaser, at least five days before the completion of the purchase or the payment therefor, to notify, personally or by registered mail, each of said creditors of the said proposed sale, the price to be paid therefor, and the terms and conditions thereof, and to give to each of said creditors a copy of the statement of the assets and liabilities as furnished him by the vendor. (Acts 1903, pp. 92, 93.)"

"28-205. (3228) **When fraud is presumed.**—Whenever any person shall purchase any stock of goods, wares, or merchandise in bulk, and shall pay the price or any part thereof, or execute or deliver to the vendor thereof, or to his order, or to any person for his use, any promissory note or other evidence of indebtedness for said purchase price, or any part thereof, without having first demanded and received from said vendor the statement under oath required by section 28-203, and without first giving to each of said creditors the notice provided for in section 28-204, such sale or transfer shall, as to any and all creditors of the vendor, be conclusively presumed to be fraudulent. (Acts 1903, pp. 92, 93.)"

"28-206. (3229) **What sales shall be deemed fraudulent or a transfer in bulk.**—Any sale or transfer of a stock of goods, wares, or merchandise out of the usual or ordinary course of the business or trade of the vendor, or whenever thereby substantially the entire business or trade theretofore conducted by the vendor shall be sold or conveyed,

or attempted to be sold or conveyed, to one or more persons, shall be deemed a fraudulent transaction or transfer in bulk in contemplation of this and the three preceding sections: Provided, that nothing contained in this and the three preceding sections shall apply to sales by executors, administrators, receivers, or any public officer under judicial process. (Acts 1903, pp. 92, 93.)"

Opinion.

In the
United States Court of Appeals
for the Fifth Circuit.

No. 17480

Fox Jewelry Company,
Appellant,

versus

John C. Lee, Trustee in Bankruptcy of Fox Jewelers, Inc., Bankrupt,
Appellee.

Appeal from the United States District Court for the Northern District of Georgia.

(March 12, 1959.)

Before Hutcheson, Chief Judge, and Cameron and Brown, Circuit Judges.

Hutcheson, Chief Judge: This is an appeal from a turnover order issued in Fox Jewelers, Inc., Bankrupt, against Fox Jewelry Company, a corporation not only in name but in every other aspect which underlies and attends

corporate existence. The purpose and scope of the order was, treating the respondent as the alter ego of Fox Jewelers, Inc., to seize and administer its assets and affairs as though its possession was the possession of the bankrupt.

The trustee, standing firmly on the finding of the referee, insists that the possession of the assets by the respondent for itself and in its own right was merely colorable, that is pretextual and feigned, and was really in right of the bankrupt.

Arguing that the fact that Feldser was the president and stockholder in both companies; that, as such, he did all the purchasing of the stocks of merchandise and generally handled the business for both companies; that, in short, he had one man control of both; and that this is a case in which there is no difficulty in piercing the corporate veil; he urges upon us that, though the two corporations conducted their business in separate towns, had separate bookkeeping, paid separate income and social security taxes, and in every respect except that they were closely affiliated one man corporations, were separate, the referee's holding, that the respondent was in effect the bankrupt and his assets were subject to be seized in a summary proceeding, was correct. We do not think so.

Without discussing the facts in detail other than as above set out, we think that there is no basis whatever in the record for the exercise of summary jurisdiction. This is not to say that there may not be ample basis for a finding in a plenary proceeding that the bankrupt has been imposed upon by the respondent, and that the respondent is accountable to the bankrupt for such imposition. It is to say, though, that the matters on which the trustee relies, control of the two corporations by the one man stockholder and president of each, the fact that they act together, and especially the fact that the purchasing of their stocks of goods are all done by the same man, is

not determinative of the question whether the corporations are in fact, as in every legal aspect they appear to be, two corporations or simply one, and the possession of the respondent was the possession of the bankrupt. If the contention of the trustee in this case is correct, then in any case merely of closely affiliated corporations, with one stockholder and one management, this claim of summary judgment could be maintained. The law is otherwise settled. **Sampsell v. Imperial, 313 U. S. 215.** In **Maule Industries v. Gerstel, 232 F. (2) 294,** this court discussed the philosophy and theory of summary jurisdiction and the reasons which underlie and support it, as well as the reasons which deny such asserted jurisdiction when those against whom it is asserted will be deprived thereby of their constitutional rights to a plenary trial with the sanctions and protections such trial affords.

The argument, which seems to be the main reliance of referee and trustee, that it is more desirable that the bankruptcy court have the summary jurisdiction contended for because it can therewith administer matters more expeditiously and more effectively protect the creditors and the estate, while good enough as far as it goes, gives too little weight to the counter contention that durable as that is, it is not sufficiently desirable to permit doing away with the safeguards and sanctions provided by law against undue celerity and the deprivation of substantial rights. The exercise of summary jurisdiction in this case is without support in the evidence and the applicable law.

The judgment is reversed and the case is remanded for further and not inconsistent proceedings.

A true copy.

Test: Edward W. Wadsworth,
Clerk, U. S. Court of Appeals, Fifth Circuit,
New Orleans, Louisiana

(Seal) April 8, 1959.

Judgment.

Extract from the Minutes of March 12, 1959.

Fox Jewelry Company,

No. 17480. versus

John C. Lee, Trustee in Bankruptcy
of Fox Jewelers, Inc., Bankrupt.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Georgia, and was argued by counsel;

On Consideration Whereof, it is now here ordered, adjudged and decreed by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and that this cause be, and it is hereby, remanded to the said District Court for further and not inconsistent proceedings in accordance with the opinion of this Court;

It is further ordered, adjudged and decreed that the appellee, John C. Lee, Trustee in Bankruptcy of Fox Jewelers, Inc., Bankrupt, be condemned to pay the costs of this cause in this Court in due course of the administration of the estate of said Bankrupt.